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# Michigan Township Participating Plan

June 30, 2004 and 2003

99-7-496

**Financial Statements**

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# **MICHIGAN TOWNSHIP PARTICIPATING PLAN**

## **FINANCIAL STATEMENTS** For the years ended June 30, 2004 and 2003

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**FOLLMER RUDZEWICZ PLC**  
Certified Public Accountants

**INDEPENDENT AUDITOR'S REPORT**

August 31, 2004

Board of Directors  
Michigan Township Participating Plan  
1700 Opdyke Court  
Auburn Hills, Michigan 48326

We have audited the accompanying statement of financial position of Michigan Township Participating Plan, (a Michigan Public Act 138 entity), as of June 30, 2004 and 2003, and the related statements of revenues and expenditures, and cash flows for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Michigan Township Participating Plan as of June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Follmer Rudzewicz PLLC*

FOLLMER RUDZEWICZ PLC  
Southfield, Michigan

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# MICHIGAN TOWNSHIP PARTICIPATING PLAN

(a Michigan Public Act 138 Entity)

## COMPARATIVE STATEMENT OF FINANCIAL POSITION

ASSETS		
	June 30,	
	2004	2003
CURRENT ASSETS:		
Cash in bank	\$ 996,538	\$ 1,337,007
Membership fees receivable	24,325	17,500
	<u>\$ 1,020,863</u>	<u>\$ 1,354,507</u>
LIABILITY		
CURRENT LIABILITY - Premiums and accounts payable	<u>\$ 930,624</u>	<u>\$ 1,256,627</u>
NET ASSETS		
BALANCE, July 1	\$ 97,880	\$ 57,659
Add: Excess of (expenditures) revenues for the years ended June 30	(7,641)	40,221
	<u>\$ 90,239</u>	<u>\$ 97,880</u>
	<u>\$ 1,020,863</u>	<u>\$ 1,354,507</u>

The attached NOTES TO FINANCIAL STATEMENTS form an integral part of these statements.

# MICHIGAN TOWNSHIP PARTICIPATING PLAN

## COMPARATIVE STATEMENT OF REVENUES AND EXPENDITURES

	For the years ended June 30,			
	2004		2003	
	Amount	Percent of Net Contributions From Members	Amount	Percent of Net Contributions From Members
<b>GROSS INSURANCE PREMIUMS</b>	\$ 25,757,740		\$ 23,470,559	
<b>LESS: Agent commissions</b>	<u>2,594,002</u>		<u>2,581,762</u>	
<b>GROSS CONTRIBUTIONS FROM MEMBERS</b>	<u>\$ 23,163,738</u>		<u>\$ 20,888,797</u>	
<b>LESS: Administrative fees to plan administrator, claims and risk control</b>	\$ 3,845,433		\$ 3,285,878	
<b>Expense for reinsurance</b>	<u>19,098,980</u>		<u>17,335,194</u>	
	<u>\$ 22,944,413</u>		<u>\$ 20,621,072</u>	
<b>NET CONTRIBUTIONS FROM MEMBERS</b>	<u>\$ 219,325</u>	<u>100.0 %</u>	<u>\$ 267,725</u>	<u>100.0 %</u>
<b>OPERATING EXPENSES:</b>				
Advertising	\$ 66,799	30.5 %	\$ 82,475	30.8 %
Travel and meetings	85,503	39.0	82,115	30.7
Newsletter publishings	26,830	12.2	22,419	8.4
Professional fees	31,688	14.4	16,431	6.1
Actuarial costs	15,000	6.8	23,194	8.7
Office supplies and expense	<u>1,146</u>	<u>.5</u>	<u>870</u>	<u>.3</u>
	<u>\$ 226,966</u>	<u>103.4 %</u>	<u>\$ 227,504</u>	<u>85.0 %</u>
<b>Excess of (expenditures) revenues</b>	<u>\$ (7,641)</u>	<u>(3.4 ) %</u>	<u>\$ 40,221</u>	<u>15.0 %</u>

The attached NOTES TO FINANCIAL STATEMENTS form an integral part of these statements.

# MICHIGAN TOWNSHIP PARTICIPATING PLAN

## COMPARATIVE STATEMENT OF CASH FLOWS

	For the years ended June 30,	
	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Cash received from members	\$ 23,156,913	\$ 20,892,697
Expenditures to reinsurer and suppliers	<u>(23,497,382)</u>	<u>(20,689,430)</u>
Net cash (used in) provided by operating activities	<u>\$ (340,469)</u>	<u>\$ 203,267</u>
 <b>NET (DECREASE) INCREASE IN CASH</b>	 \$ (340,469)	 \$ 203,267
 <b>CASH, at beginning of year</b>	 <u>1,337,007</u>	 <u>1,133,740</u>
 <b>CASH, at end of year</b>	 <u><u>\$ 996,538</u></u>	 <u><u>\$ 1,337,007</u></u>
 <b>RECONCILIATION OF THE EXCESS OF REVENUES TO NET CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Excess of revenues	\$ (7,641)	\$ 40,221
Adjustments to reconcile the excess of revenues to net cash flows from operating activities:		
Changes in:		
Membership fees receivable	(6,825)	3,900
Premiums and accounts payable	<u>(326,003)</u>	<u>159,146</u>
 <b>NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES</b>	 <u><u>\$ (340,469)</u></u>	 <u><u>\$ 203,267</u></u>

The attached NOTES TO FINANCIAL STATEMENTS form an integral part of these statements.

# MICHIGAN TOWNSHIP PARTICIPATING PLAN

## NOTES TO FINANCIAL STATEMENTS

For the years ended June 30, 2004 and 2003

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### NOTE A SUMMARY OF ACCOUNTING POLICIES

The following is a summary of certain accounting policies followed in the preparation of these financial statements. The policies conform to accounting principles generally accepted in the United States of America and the procedures provided by the Michigan Department of Treasury as required under Section 124.8(2) of the Michigan Compiled Laws and have been consistently applied in the preparation of the financial statements.

#### Plan Operations

The Michigan Township Participating Plan was established April 1, 1985, pursuant to laws of the State of Michigan which authorize local units of Government to exercise jointly any power, privilege or authority which each might exercise separately. The purpose of the Plan is to jointly exercise powers common to each participating member to establish and administer a risk management program; to prevent or lessen the incidence and severity of casualty losses occurring in the operations of its members; and to defend and protect any member of the authority against liability or loss. The powers, duties and the described activities of the Plan are not intended to constitute the issuance of a policy of insurance. The members intend, in the creation of the Plan, to establish an organization for joint risk management and have not created as between member and member any relationship for the debts of or claims against any member.

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Revenue Recognition

The Plan generally recognizes revenue when persuasive evidence of an arrangement exists, service occurred, the fee is fixed or determinable, and collectibility is probable.

#### Concentration of Credit Risk

The Plan may, from time to time during the years covered by these financial statements, have bank balances in excess of FDIC insured limits. Management has deemed this as a normal business risk.

#### Income Taxes

The Plan is a municipal self-insurance entity operating pursuant to the State of Michigan Public Act 138 of 1982. This law allows local governmental units to provide joint funding for risk management and self-insurance purposes.

A ruling has been received from the Internal Revenue Service stating that the Plan is a corporation in form but the activities are not subject to taxation, therefore no provision has been made for income taxes.

#### Advertising

Advertising costs are expensed as incurred.

### **NOTE B SELF-RETENTION AND REINSURANCE**

The Michigan Township Participating Plan, while it operates under the Michigan Legislation of Public Act 138, does not operate as a risk pool due to a total transfer of risk to reinsurance companies backing the Michigan Township Participating Plan. Due to this reinsurance purchase, there is no pooling of risk between members. The Plan has protected itself in the event reinsurance becomes uncollectible by purchasing a reinsurance treaty for uncollectible reinsurers. Amounts paid toward the reinsurance treaty are expensed as incurred and totaled \$50,000 and \$0 for the years ended June 30, 2004 and 2003.

During the years ended June 30, 2004 and 2003, gross member assessments written were \$25,757,740 and \$23,470,559, respectively. The amount of member assessments paid to reinsurers was \$19,048,980 and 17,335,194, respectively. The amount of member assessments assumed from other entities was \$0, and the net amount of member assessments retained was \$219,325 and \$267,725, respectively.

The Michigan Township Participating Plan chose to adopt the forms and endorsements of conventional insurance protection and to reinsure these coverages 100%, rather than utilize a risk pool of member funds to pay individual and collective losses up to a given retention, and then have reinsurance above that retention amount.

The individual members are responsible for their self-retention amount, which vary from member to member.

The Michigan Township Participating Plan completed its second year of a two-year reinsurance contract on March 31, 2003. In order to secure this multi-year reinsurance contract, the Plan granted the program's reinsurers the option to cancel at April 1, 2002 and not renew for the second year of the contract in the event that the Plan's annual actuarial report indicated that the ultimate loss and loss adjustment expense ratio for accident year ending June 30, 2001 was 73% or greater. The actuarial report showed that the results for that accident year were less than 73% and this provision was not an issue.

In the event that the Plan's loss ratio did exceed 73% and the reinsurers had elected not to renew for the second year, reinsurance coverage for all policies in force as of the April 1st renewal date would not have been affected as the reinsurers are obligated to run off all of those policies through their expiration. In addition, the Plan would have had to renegotiate a new reinsurance contract at April 1, 2002, similar to an insurance company that is on annual reinsurance terms.

An additional provision of the multi-year reinsurance treaty stated that the reinsurers could cancel if there was a material change in ownership or management of the Plan, including a change in the underwriting manager (Kenrick Corporation) without prior consent of the reinsurers. This provision was required to assure consistency in management and in the processes and procedures that have historically been used to generate the Plan's loss results. In the event that a material change did occur, the Plan would need to obtain the consent of the reinsurers prior to the change, or negotiate alternate reinsurance contracts.



The Plan entered into a new multi-year reinsurance contract effective April 1, 2003 through March 31, 2005. Both of the above provisions are contained in this reinsurance contract.

With respect to the loss ratio provision, the Plan's annual actuarial report indicates that the ultimate loss and loss adjustment expense ratio continues to be below 73%.

At the present time, the Plan does not anticipate any material change in ownership or management, including a change in the Plan's underwriting manager.

#### **NOTE C UNRECOVERABLE REINSURANCE**

The Plan entered into a reinsurance agreement on June 30, 2003 with Motors Insurance Corporation, a subsidiary of General Motors, to provide protection to the Plan members in the event that the Plan had difficulties in the collection of claim recoverables from one or more of the reinsurers. At June 30, 2004 this unrecoverable agreement had a limit of \$1,662,650. This agreement allows the Plan the option to increase the limit of protection through additional premium payments.

#### **NOTE D INCOME AND EXPENSE RECOGNITION**

As discussed in Note B, the Plan does not operate a risk pool, but provides conventional insurance protection and reinsures these coverages one hundred percent. As such, when contributions are received from members, they are immediately turned over to the plan administrator for remittance to reinsurers, less administrative fees, on a timely basis. During the years ended June 30, 2004 and 2003, the costs for risk control and claims administration were included in the rate paid to the administrator.

#### **NOTE E PLAN TERMINATION**

While the board is not presently considering Plan termination, the Plan may cease its activities upon a three-fourths vote of the members to such effect. The Plan shall be administered by the Board of Directors holding office on the effective date of the termination until all of the Plan's affairs are completed.

#### **NOTE F LOSS RESERVES**

The Plan has reinsured one hundred percent of its loss reserves and consequently has not reflected a liability for loss reserves on its statement of financial position.